#### DRAFT/REDACTED

### PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

#### **ENERGY DIVISION**

E-6 ID#2422 **RESOLUTION E-3825 July 10, 2003** 

### RESOLUTION

Resolution E-3825. Pacific Gas and Electric Company (PG&E) requests expedited approval of its Gas Supply Plan for the period of March 1, 2003, through August 31, 2003, to be used in connection with its responsibilities related to certain California Department of Water Resources (DWR or "Department") contracts which include gas tolling provisions. PG&E's request is approved as modified.

By Advice Letter 2359-E. Filed on March 25, 2003.

### **SUMMARY**

PG&E's Gas Supply Plan, describing the utility's strategy to administer the gas tolling arrangements of DWR electricity contracts, is approved with modifications. The modified Gas Supply Plan shall be in effect for the period beginning March 25, 2003 and until its next Gas Supply Plan is approved by the Commission.

PG&E shall revise its Gas Supply Plan to conform with the terms of the Commission's Operating Order and the utility's approved Operating Agreement as well as to incorporate several approved DWR recommendations. The utility is directed to file a supplemental advice letter reflecting the required changes.

PG&E shall present a proposal in its next Gas Supply Plan for obtaining natural gas storage capacity as of April 1, 2004 which shall include minimum gas storage target levels as of May 31, 2004. Additionally, PG&E shall include proposed procedures for making available any existing unused storage or pipeline capacity holdings to the other electric utilities in connection with their administration of DWR contracts.

All text appearing [Redacted] in the redacted version and shaded in the confidential version of the resolution will be made available to the public upon Commission approval of this resolution.

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PG&E's next Gas Supply Plan is to be filed August 15, 2003 for the period of October 1, 2003 through March 31, 2004.

The protest of DWR is granted in part.

The protest of the Office of Ratepayer Advocates (ORA) is denied.

### **BACKGROUND**

On October 25, 2001, the Commission opened Rulemaking (R.) 01-10-024 to establish mechanisms enabling PG&E and the state's other major electric utilities to resume purchasing electricity to meet their customer's needs. The utilities were unable to procure electricity due to their financial situation and the market disruptions arising from the so-called "energy crisis". As a result, DWR was authorized to contract for electricity supplies on behalf of the customers of PG&E, Southern California Edison (SCE) and San Diego Gas & Electric (SDG&E) (hereafter referred to collectively as the "utilities"). The rulemaking was necessary because DWR's statutory authority to buy electricity was set to expire December 31, 2002. Following is a discussion of various decisions issued in this rulemaking proceeding related to the subject of this resolution.

In Decision (D.) 02-09-053, the Commission allocated the long-term DWR power purchase contracts to the resource portfolios of the utilities. As of January 1, 2003, the utilities would be obligated to schedule and dispatch the contracts while DWR would retain legal and financial responsibilities. The utilities were also instructed to integrate the DWR contracts with their existing supply portfolios and new procurement contracts and to manage these resources under the operating rule of "least-cost" dispatch.

The Commission also considered the utilities administration of the DWR contracts containing "gas tolling" provisions. These provisions provide DWR with the option to either (i) accept the generator's price for gas used in electricity production or (ii) procure gas supplies on its own initiative. Since proper management of the gas tolling arrangements is a critical aspect of least cost dispatch, the Commission determined that the utility's operational and administrative responsibilities of the DWR contracts should apply to the implementation of the gas tolling provisions with DWR holding financial and legal responsibilities.

In D. 02-10-062, the Commission established the regulatory framework enabling the utilities to resume full procurement on January 1, 2003 consistent with their obligation to serve. Minimum standards of conduct were adopted governing the behavior of utility employees and outlining acceptable procurement practices. Such standards included a prohibition against self-dealing to the benefit of an affiliate of the utility and the requirement for the utilities to prudently administer all contracts and dispatch energy in a least-cost manner. The decision ordered the utilities to file updated procurement plans reflecting the allocated amounts of DWR power resulting from D.02-09-053 and expanding on risk management strategies.

In D. 02-12-069, the Commission adopted an Operating Order memorializing the obligations that DWR and the utilities would assume beginning January 1, 2003 for the administration of the allocated DWR long term power contracts. The decision also established up-front standards of review governing the utilities' administration of the DWR contracts and adopted the standards previously set forth in D. 02-10-062. $^{1}$  2

Among the sections in the Operating Order is "Exhibit B, Fuel Management Protocols" specifying the operating relationship between DWR and the utilities concerning management of the gas tolling provisions. Under Exhibit B of the Operating Order, the utilities, acting as a limited agent for DWR, are charged with conducting the administrative and operational aspects of the gas tolling provisions while DWR holds legal and financial responsibility. The exhibit

<sup>&</sup>lt;sup>1</sup> D. 02-12-069, "We adopt the standards previously adopted in D.02-10-062 with the explicit inclusion of a "least-cost" dispatch requirement." (see p. 61, *mimeo*) Additionally, the decision adopted the following up-front standards of conduct:

<sup>&</sup>quot;1. The utilities shall prudently administer all contracts and generation resources and dispatch the energy in a least-cost manner. Our definitions of prudent contract management and least cost dispatch are the same as our existing standard.

<sup>2.</sup> The utilities shall not engage in fraud, abuse, negligence, or gross incompetence in negotiating procurement transactions or administering contracts and generation resources." (see Ordering Paragraph 4)

<sup>&</sup>lt;sup>2</sup> D. 02-12-074, granted in-part PG&E's petition to modify several standards of behavior.

provides specific guidelines governing the utilities' actions in cases where gas tolling provisions are exercised pursuant to DWR approval, as follows:

- 1. Utility shall use reasonable commercial efforts to deliver gas in a reliable manner and consistent with gas requirements for producing scheduled energy.
- 2. Utility shall develop a portfolio of gas supply for DWR Contracts that contain Fuel Options and where Utility is to procure the gas, consistent with the approved Fuel Plans. Such portfolio should be diversified in terms of price mechanism, period of performance, and gas suppliers.
- 3. Utility shall develop a portfolio of supply which is cost-effective relative to the market.

Additionally, the exhibit specifies that the utilities are responsible for these activities: 1) determining types and lengths of gas contracts; 2) nominating deliveries; 3) contracting for gas transportation and storage; 4) managing imbalances; 5) reviewing, authorizing and making payment of gas invoices, and; 6) determining and implementing hedge strategies, as appropriate.<sup>3</sup>

In addition to defining each party's respective roles, Exhibit B also requires each utility to prepare Gas Supply Plans, with the following purpose:

"The utilities are responsible for preparing "Gas Supply Plans "detailing their strategies for procuring gas and proposed use of risk management instruments. These plans will set parameters under which the utilities will perform various gas-related activities pursuant to the gas tolling provisions. The utilities shall file these plans for Commission approval through Advice Letter filings on a semi-annual basis. The Commission will review and approve these plans on an expedited basis. Following approval of the Gas Supply Plans, the utilities will negotiate with suppliers

<sup>&</sup>lt;sup>3</sup> In the case of gas hedging, D.02-12-069 instructed the utilities to make the final decision related to the use of risk management tools and that they should work with DWR immediately to enter into any necessary forward hedges (see p. 28, *mimeo*).

for gas supplies, transportation and storage. Negotiated agreements will then be submitted to DWR for execution." (D. 02-12-069, p. 27, *mimeo*)

#### Furthermore,

"In particular, with respect to gas purchasing, transportation, storage and risk management, we believe DWR should limit its involvement to the review of the utility's Gas Supply plans and that, following Commission approval of these plans, the utilities should be free to negotiate and present agreements for DWR execution without subsequent DWR approval." (D. 02-12-069, p. 28, *mimeo*)

In D. 02-12-074, the Commission approved the updated short-term procurement plans filed in response to D.02-10-062 for each utility. The procurement plans provide the up-front standards by which the utilities will procure electricity to meet customer needs during 2003. PG&E's approved procurement plan included a description of its methods for managing its generation portfolio (e.g., retained generation, contracts with Qualifying Facilities (QF), existing bilaterals, and the allocated DWR contracts) pursuant to least cost principles. Among the operating practices approved in PG&E's short term procurement plan [Redacted] This decision also granted in part a petition to modify several of the standards of behavior adopted in D. 02-10-062.

On March 25, 2003, PG&E filed Advice Letter (AL) 2359-E requesting Commission review and expedited approval of its Gas Supply Plan for the period March 1, 2003, through August 31, 2003. <sup>4</sup> The AL represents PG&E's initial Gas Supply Plan filing.<sup>5</sup> The AL noted that a draft of the plan was provided to the Procurement Review Group<sup>6</sup> for its review and that revisions

<sup>&</sup>lt;sup>4</sup> The protest period for the AL was extended to April 4, 2003 with replies due 3 days thereafter per PUC letter signed by Commission Executive Director, William Ahern, dated March 28, 2003.

<sup>&</sup>lt;sup>5</sup> PG&E filed a confidential version of its Gas Supply Plan pursuant to PUC Code section 583 and the May 1, 2002, Protective Order in R. 01-10-024 and circulated a redacted version. The plan consists of two appendices: Appendix A (Generator Fuel Plan Pricing Mechanisms) and Appendix B (Pipeline Storage and Tariffs).

<sup>&</sup>lt;sup>6</sup> D.02-08-071 established "Procurement Review Groups", whose members are Commission Energy Division staff, ORA and appropriate interested parties that are not market participants as defined in the May 1, 2002 PUC Protective Order and who agree to execute an appropriate non-disclosure agreement, having the right to consult with and review the details of the utilities interim procurement strategy and related items. (see p. 24, *mimeo*)

were made based on comments received from the ORA. The utility also states that DWR reviewed the proposed plan. Furthermore, the utility determined that its Gas Supply Plan would not require changes if the Commission adopted an Operating Agreement (further described below) presented in a proposed decision issued by Administrative Law Judge Halligan in R. 01-10-024.

In its Gas Supply Plan, PG&E states that it intends to develop a portfolio of gas supplies and use transportation and storage services to provide a cost effective fuel supply for the DWR contracts and that its management of the DWR contracts is a component of its Commission approved short term procurement plan.<sup>7</sup> To support strategies presented in the Gas Supply Plan, PG&E conducted an analysis of projected gas costs and volumes for two cases: 1) generators supply gas for electricity production, and; 2) the utility, as limited agent of DWR, assumes the gas procurement function.

For situations where PG&E is to furnish gas supplies as a limited agent for DWR, the Gas Supply Plan presents the following items and strategies: 1) a list of gas suppliers pre-approved by DWR; 2) brokerage firms pre-approved by DWR for financial trading; 3) an interstate, intrastate, distribution and Canadian pipeline plan; 4) a gas storage plan; 5) gas price risk management strategies; 6) a gas operations plan; 7) a description of the functions of its Electric Fuels Management Group; 8) gas scheduling, nomination and management of imbalances, and; 9) an invoice review and approval process.

The Gas Supply Plan lists the following pricing methods PG&E intends to use for the majority of its gas purchases under the gas tolling arrangements:

PG&E AL 2359-E Gas Supply Plan Pricing Methods		
Pricing Method:	Description:	
Intra-day Fixed	Fixed price for nominations during cycles 2 – 4.	
Daily Fixed	Fixed price for gas the following day (cycle 1).	
Monthly Fixed	Fixed price for a fixed daily volume for a calendar month.	
Daily Index	Floating price for a single day, published on the day of flow by Gas Daily (or	
	Monday for Sat, Sun & Mon).	

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<sup>&</sup>lt;sup>7</sup> PG&E's Gas Supply Plan notes that the utility has been supplying gas as a limited agent of DWR since early 2003 pursuant to two contracts with Calpine and that the utility was allocated a total of 21 DWR contracts. All the allocated contracts are dispatchable and 13 of these, representing 6 different counterparties, contain gas tolling provisions.

Monthly Index	Floating price for a fixed daily volume for a calendar month, published after the	
	close of the NYMEX contract for the month of flow by NGI.	

The Gas Supply Plan lists the following risk management tools PG&E may use for the DWR contracts during the term of the plan:

PG&E AL 2359-E Gas Supply Plan Risk Management Tools				
Product:	Physical Product Use:	Financial Product Use:		
Fixed Price	Buy forward at a fixed price.	None.		
Index/Swap for fixed	Buy forward at monthly index.	Swap floating price for fixed.		
Index/Futures+Basis	Buy forward at monthly index.	Long futures & long basis swap.		
Swing Swap	Buy forward at monthly index.	Swap monthly floating price for		
		daily floating price.		
Index/Buy Call Option	Buy forward at monthly index.	Buy call option.		
Index/Buy Collar	Buy forward at monthly index.	Buy collar (sell put, buy call).		

Prior to receiving Commission approval of its proposed Gas Supply Plan, PG&E states it will submit all gas supply, transportation and hedge deals to DWR for review and approval before making any commitments. Once the plan is approved, the utility says it will submit all supply, transportation and storage deals not contemplated in the plan to DWR for review and approval.

Confidential items are discussed in the confidential appendix to this resolution.

Following PG&E's filing of AL 2359-E, the Commission issued D. 03-04-029 adopting Operating Agreements between DWR and PG&E and San Diego Gas and Electric Company, respectively. If these utilities file executed Operating Agreements with the Commission, the Operating Order will no longer govern their activities with respect to the DWR allocated contracts.

On April 17, 2003, PG&E filed AL 2374-E submitting an executed copy of its Operating Agreement, effective April 17, 2003.<sup>8</sup> As a result, the Operating Agreement supercedes the Operating Order and controls the utility's gas tolling activities and its relationship with DWR. The Operating Agreement is

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<sup>&</sup>lt;sup>8</sup> By PUC letter to PG&E Director of Regulatory Relations dated May 12, 2003.

<sup>&</sup>lt;sup>9</sup> PG&E notes in AL 2374-E that it is filing a Petition to Modify D. 03-04-029 concurrently with SDG&E to correct certain errors it identified in the executed Operating Agreement with DWR.

substantially similar to the Operating Order and maintains the general lines of authority with PG&E assuming administrative and operational duties as a limited agent of DWR and the Department retaining financial and legal responsibility. In contrast to the Operating Order, the Operating Agreement, allows DWR to impose additional limitations on the utilities' activities concerning gas supply arrangements and pipeline and storage negotiations and specifies that any such limitation shall be incorporated in the Gas Supply Plans (referred to as "Utility Gas Supply Plans" in the Operating Agreement). Additionally, the goals and guidelines covering implementation of the gas tolling agreements are somewhat modified in the Operating Agreement.

Under the Operating Agreement, the Gas Supply Plans are to be reviewed and approved by DWR as well as the Commission, with DWR notifying the Commission of its action. A remedy is adopted in cases where DWR and the Commission approve or reject different aspects of the utility's Gas Supply Plan. Where DWR only approves a subset of what the Commission approves, the utility shall operate within the sphere of DWR's approval. If, however, the Commission explicitly rejects portions of the Gas Supply Plan that DWR would authorize, then the utility must operate within the limitations of the Commission's decision. <sup>10</sup>

On April 16, 2003, the Energy Division submitted a data request to PG&E about the Gas Supply Plan requesting clarification of certain plan elements, details of decision-making processes, and the status of various models and procedures said to be under development. Additionally, the utility was asked to explain how the strategies outlined in the plan support the goals and objectives of the Operating Order and Operating Agreement. On April, 24, 2003, the utility submitted a response to the data request.

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<sup>&</sup>lt;sup>10</sup> D.03-04-029, PG&E Exhibit B, Fuel Management Protocol, Section IV, Fuel Procurement Strategies: "In the event of conflicting guidance between the Commission and DWR regarding various aspects of the Gas Supply Plan they respectfully approve or reject, where DWWR only approves a subset of what the Commission approves, then Utility shall operate within the sphere of DWR's approval. If, however, the Commission explicitly rejects portions of the Gas Supply Plan that DWR would authorize, then Utility must operate within the limitations of the Commission's decision."

Resolution E-3825 PG&E AL 2359-E/cpe

# **NOTICE**

Notice of AL 2359-E was made by publication in the Commission's Daily Calendar. PG&E states that a copy of the Advice Letter was mailed and distributed in accordance with Section III-G of General Order 96-A.

# **PROTESTS**

On April 4, 2003, the Office of Ratepayer Advocates (ORA) filed comments in support of the AL based upon its limited review of the Gas Supply Plan. ORA noted that approval of the AL should not affect the review of the utility's actions conducted in its ERRA (Energy Resource Recovery Account) filing. Further, ORA recommends that PG&E should use DWR credit support only to produce lower expected gas prices and that the Gas Supply Plan's diverse set of tools may generate cost savings. In conclusion, ORA stated that the Gas Supply Plan is a fully featured plan providing adequate detail for Commission approval.

On April 8, 2003, PG&E submitted its response to ORA's protest disputing their characterization of the ERRA review and stating that compliance with the approved plan is the only item which will be considered in the proceeding. PG&E notes that DWR credit support is needed to quell supplier concerns about the utility's substandard credit rating and for executing hedges. Additionally, PG&E says that use of DWR credit is consistent with the Department's financial responsibility of the allocated contracts.

On April 7, 2003, DWR submitted a memorandum with comments about PG&E's Gas Supply Plan and requested some modifications. DWR generally seeks clarification about some aspects of the plan and proposes to condition the utility's actions to a set of protocols to be imposed at a later date. DWR also suggested that additional discussion about the plan was appropriate.

On April 11, 2003, PG&E submitted a public and redacted version of its response to DWR's comments. The utility generally asserts that DWR's proposal to condition approval of the Gas Supply Plan on a set of unseen protocols is unreasonable. Additionally, PG&E responded to the Department's request for clarification of certain items and agreed to adopt several suggestions involving invoice processing, gas transactions and hedges. With regard to further discussions, PG&E notes that it consulted with its Procurement Review Group and DWR staff about the plan prior to filing.

### **DISCUSSION**

The state's major electric utilities have considerable influence over generation costs through their administration of the DWR contract gas tolling provisions. With this responsibility, the utilities gain substantial control over procuring gas supplies, negotiating for pipeline and storage capacity and for related activities. Failure to properly manage these functions may harm ratepayers if avoidable costs inflate electricity rates. To demonstrate that the utilities will diligently undertake their gas tolling related duties, we required them to prepare and submit Gas Supply Plans for our approval.

Our review is focused on determining whether PG&E's Gas Supply Plan: (1) maintains the requisite operational relationship between the utility and DWR with the utility performing the required administrative activities, and; (2) shows that the utility is prepared to manage the gas tolling provisions in support of our procurement goals and objectives.

We will consider the reasonableness and effectiveness of PG&E's actions administering the DWR contract gas tolling provisions as well as compliance with its Gas Supply Plan under the processes established in D. 02-09-053. This decision specified that we will conduct a comprehensive review of the utilities' procurement activities including the administration of the DWR allocated contracts annually. As we explained in D.02-09-053, this review will be carried out as follows:

"The reasonableness of the utilities' administration of the DWR contracts we allocate today, including how they elect to dispatch the contract power quantities relative to other resources in their portfolio, shall be at issue over the life of the contracts. The forum for the Commission's review of the reasonableness of DWR contract administration shall be the annual procurement proceeding, where the utility procurement process as a whole is reviewed." (see Ordering Paragraph 2)

With the burden to demonstrate how the DWR contracts were administered, the utility shall document and retain the analyses, forecasts and related information used to support decisions made to implement the gas tolling provisions.

Before we analyze PG&E's Gas Supply Plan, we must consider the impact that the utility's approved Operating Agreement, which supersedes the Operating Order, may have on our review. As discussed above, PG&E filed AL 2359-E prior to the effective date of its Operating Agreement. The utility recognized that this situation may arise and indicated that revisions to its Gas Supply Plan were not necessary under either the Operating Order or the Operating Agreement; no party challenged this contention. We note that PG&E observed our recommendation in D.03-04-029 (adopting the Operating Agreement) and furnished a draft of its Gas Supply Plan to the Procurement Review Group and DWR for their review. As such, the Gas Supply Plan may be reviewed under the Operating Agreement as filed without any additional procedural steps. Accordingly, we conclude that the terms and conditions of PG&E's Operating Agreement apply to the utility's gas tolling related activities as of April 17, 2003, the date that the utility's Operating Agreement went into effect (prior to this date the Operating Order governs). We request that DWR provide written notification to the Commission regarding its approval or rejection of PG&E's Gas Supply Plan, as contemplated under the Operating Agreement. 11

# Operational relationship with DWR and administrative duties:

Our first consideration is whether PG&E's Gas Supply Plan maintains the clear lines of authority established for the utility and DWR in connection with the implementation of the gas tolling provisions. Under both the Operating Order and Operating Agreement (hereafter collectively referred to as the "Operating Documents"), the utility is responsible for performing all administrative and operational related activities associated with the gas tolling arrangements as a limited agent of DWR and that DWR retains any and all related legal and financial obligations. Activities undertaken by the utility to manage the gas tolling provisions must uphold this functional distinction. As specified in the Operating Agreement, Exhibit B, Part I (a substantially similar provision is contained in the Operating Order):

"The intent of this relationship is to provide Utility with sufficient flexibility and authority to execute normal day-to-day activities associated

 $^{11}$  D.03-04-029, PG&E Exhibit B, Fuel Management Protocols, Section IV, "DWR shall also formally notify the Commission when it has approved such plan."

with managing the fuel provisions of tolling Contracts and procurement of natural gas and related services, as a limited agent acting on behalf of DWR without direct involvement by DWR but in a manner consistent with Utility Gas Supply Plans which have been reviewed and approved by DWR and the Commission."

With this initial focus, we note that PG&E's Gas Supply Plan explicitly states that the utility will function as a limited agent of DWR and the plan contains elements called for in the Operating Documents necessary to meet its operational and administrative responsibilities. Looking at the plan in detail, we find these necessary elements included: (1) provisions for negotiating gas purchases from approved DWR gas suppliers, (2) procedures for scheduling and nominating gas supplies to generation facilities, (3) provisions for the use of pipeline and storage capacity, (4) management of imbalances, and (5) risk management procedures. The plan discusses the utility's election to manage the DWR contracts as either the Fuel Supplier or Fuel Manager in accordance with the DWR contracts.<sup>12</sup> For day-to-day administrative functions, a Gas Operations Plan is provided showing the duties of its Electric Fuels Management Group to schedule gas supplies, monitor pipeline availability, and manage imbalances in accordance with utility rules, tariff requirements and DWR contract terms. 13 The role of DWR is preserved to the extent that the utility will review and approve invoices for Department payment.

We find that, except for the items discussed below, PG&E's Gas Supply Plan maintains the authorized division of responsibilities between the utility and DWR and that the utility has presented a plan showing it can fulfill its operational obligations. Although the plan notes that the utility's actions may be constrained due to the terms of the DWR contracts and the Department's credit and collateral situation, we find such limitations acceptable under the terms of

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<sup>&</sup>lt;sup>12</sup> According to the PG&E's Gas Supply Plan, the Fuel Supplier purchases and delivers gas to the Fuel Manager at the PG&E citygate or a pre-determined location whereas the Fuel Manager receives gas from the Fuel Supplier and manages daily and monthly deliveries from the Citygate (or other point) to the plant (see discussion in Confidential Appendix).

 $<sup>^{13}</sup>$  Under the Operating Order, Exhibit B, Part II, Fuel Activities, under the operating documents, the utilities' activities must be consistent with the terms of the contracts with fuel options. Furthermore, D.02-12-069, p. 30, "We grant SDG&E and PG&E's request, and agree that DWR rather than the utilities should provide credit support for gas purchases related to the DWR contracts."

the D. 02-12-069.<sup>14</sup> Adherence to the procedures presented in PG&E's Gas Supply Plan should result in delivering gas to generators in the reliable manner called for in the goals and guidelines listed in the Operating Documents.

# Gas Supply Plan inconsistencies and omissions:

We find the following elements of PG&E's Gas Supply Plan to be inconsistent with the Operating Documents or contravene the required relationship between the utility and DWR:

1) PG&E states in its Gas Supply Plan that it will submit all supply, transportation and storage deals exceeding terms of three months or value of \$10 million for DWR review and approval, if the Operating Agreement is approved (see p. 18).

The Operating Agreement does not contain such terms regarding transactions involving gas transportation and storage transactions, only in the case of gas purchases. Specifically, the Operating Agreement, in Section V., Gas Purchasing contains the following: "If Utility determines it would be beneficial to enter into any DWR gas contract which exceeds 3 months or have a total value exceeding \$10 million, it shall negotiate such agreement(s) and submit them to DWR for advance approval and execution." We deny PG&E's proposal to unilaterally impose this condition for gas transportation and storage deals.

- 2) We require PG&E to conduct its activities as Fuel Supplier and Fuel Manager in the manner discussed in the Confidential Appendix.
- 3) PG&E's Gas Supply Plan states that it will add to its list of financial risk management products, subject to DWR concurrence (see p. 23).

The Operating Order does not condition the approval of such products on DWR approval. The Operating Agreement stipulates that the utility's activities under the Gas Supply Plan are subject to both Commission and DWR approval. We

<sup>14</sup> D.02-12-069, "We grant SDG&E and PG&E's request, and agree that DWR rather than the utilities should provide credit support for gas purchases related to the DWR contracts." (see p. 30, *mimeo*)

require PG&E to observe this condition when seeking to add to its list of risk management products.

4) In its response to the Energy Division data request about the definition of a "standard gas price hedge" appearing in the Gas Supply Plan (see p. 23), PG&E stated that each hedge transaction must be [Redacted].

# [Redacted]

Additionally, the Gas Supply Plan lacks procedures for forwarding negotiated arrangements for gas supplies, pipeline, storage and related services to DWR for execution as contemplated in the Operating Documents. The plan also fails to specify that all negotiated agreements will specifically authorize the utility to act for and on behalf of DWR as a limited agent. We direct the utility to observe these protocols and establish the necessary implementation procedures to meet these obligations.

# Gas Supply Plan decision-making processes and Commission objectives:

In addition to ensuring that the Gas Supply Plan contains the required elements and maintains the proper operational relationship between PG&E and DWR, we must also examine whether strategies described in the plan support our procurement proceeding objectives. This is an important consideration since approval of the Gas Supply Plan will give PG&E additional discretion to negotiate with suppliers for pipeline and storage services and other activities, which may directly impact generation costs.

Under the minimum standards of behavior adopted in D. 02-10-062, as modified in D. 02-12-074, the utilities are required to manage their generation resources, including the DWR allocated contracts, in the following fashion:

"Prudent contract administration includes administration of all contracts within the terms and conditions of those contracts, to include dispatching dispatchable contracts when it is economical to do so. In administering contracts, the utilities have the responsibility to dispose of economic long power and to purchase economic short power in a manner that minimizes ratepayer costs. Least-cost dispatch refers to a situation in which the most cost-effective mix of total resources is used, thereby minimizing the cost of delivering electric services." (D.02-12-074 p. 74, mimeo, emphasis added)

A critical aspect toward achieving this least-cost objective is that the utilities are to manage the gas tolling provisions in a fiscally responsible manner. This principal was expressed in D.02-12-069, which extended the standards of behavior to include the administration of the DWR allocated contracts and adopted up-front standards as well. According to D.02-12-069:

"Gas tolling provisions are not unusual in contracts that involve combustion turbine technologies. From an operational standpoint, they provide the contract administrator with an opportunity to minimize an important component of variable costs (i.e., fuel) under these contracts through the regular review of fuel plans and consideration of alternate gas supply options. The utility, and not DWR, should now assume this function because it goes hand in hand with the objective of economic dispatch (to minimize operating costs) for which the utility is now clearly responsible." (D.02-12-069, p. 48, *mimeo*)<sup>15</sup>

In addition to the these broad policy objectives, goals and guidelines specified in the Operating Documents require PG&E to develop a diversified gas portfolio that is to be reasonably priced and cost effective relative to the market.

With these considerations in mind, we will examine the strategies presented in PG&E's Gas Supply plan to determine whether the utility's decision-making processes will support our objectives and can produce results in the interest of the state's ratepayers. These strategies are: gas procurement, pipeline and storage use, and risk management.

### Gas procurement:

PG&E states in its Gas Supply Plan that it intends to build a cost-effective fuel supply for the DWR contracts. The utility says it will develop a diverse gas supply portfolio using a variety of pricing mechanisms and different DWR approved suppliers. These pricing methods include the use of floating and fixed products with varying durations and gas volumes. A list of DWR approved gas suppliers are included in the plan, which PG&E must use. PG&E says it will

 $^{15}$  The Operating Agreement contains goals and guidelines supportive of this dispatch performance standard.

establish accounts with these suppliers to conduct transactions as a limited agent of DWR. The utility indicates that it will use these suppliers subject to DWR credit limits and will seek to add approved suppliers if necessary. [Redacted]

We emphasize that PG&E must take steps to minimize gas supply costs particularly since such expenses will be a significant amount; estimated to be [Redacted] To manage the gas procurement function, we find that PG&E's gas procurement strategy of using a combination of different pricing methods should provide the utility with flexibility to respond to favorable market conditions and to synchronize gas purchases with its intended dispatch regimen. Also, using different DWR approved gas suppliers and purchasing gas at various delivery points should result in supply basin diversity. Additionally, spreading gas purchases among several different suppliers can minimize the potential risk of a supplier's non-performance due to adverse financial conditions. Basing its gas purchasing decisions on economic considerations should enable PG&E to obtain attractively priced gas supplies relative to the market.

### Pipeline and storage capacity and use:

PG&E describes in its Gas Supply Plan the general methods it will use to consider the use of interstate, Canadian, intrastate, distribution pipeline and storage capacity to service the gas tolling arrangements. The utility also evaluated the use of the pipeline capacity it assumed with the PacifiCorp contract (on TransCanada Alberta, TransCanada British Columbia and PG&E Gas Transmission Northwest) and Wild Goose Storage inventory and injection/withdrawal rights acquired by DWR. [Redacted]

We note that PG&E's responsibility to negotiate terms for pipeline or storage capacity as well as utilize existing assets represents a significant opportunity for the utility to reduce gas tolling related electric generation costs. While the utility's Gas Supply Plan includes the utility's initial decision regarding the use of pipeline and storage capacity, the plan lacks sufficient detail to examine how these decisions were made and whether it intends to continue to monitor the market for opportunities to obtain or use these services. In its reply to the Energy Divisions data request, the utility provided insights into factors used to support its decisions as well as its intentions to evaluate its position on an ongoing basis. This showing indicates that the utility will base its decisions [Redacted] potentially resulting in cost benefits consistent with our procurement objectives. We remind the utility to observe the Operating Documents

stipulation that the utility is responsible to recommend to DWR those pipelines it intends to use to transport gas.

Furthermore, PG&E notes in its Gas Supply Plan that it has access to firm natural gas storage capacity through the DWR contract with Wild Goose Storage, [Redacted]

The Commission is very concerned about the upward trend in natural gas prices, and the increasing volatility in natural gas prices. One of the reasons for these high prices and increasing volatility is the low level of natural gas in storage nationally. The lack of natural gas in storage by noncore customers was one of the contributing factors to high natural gas prices in California in 2000-2001. We believe that storage should be considered for use by the state's electric utilities as a hedge against high natural gas prices, particularly during the summer. The use of storage may be beneficial not only for a particular utility's customers, but for the state as a whole. It may help to lower the volume of flowing supplies that will be purchased during the summer, and thus help keep prices in check statewide.

At this point in time, we are already well into the summer, and we do not have an adequate record to determine in this resolution what would be an appropriate amount of storage for this summer. Nor do we have adequate information to say exactly how much storage capacity should be obtained. (Also, we note that the current natural gas supply picture for the state is improving and appears adequate for this time of year. Positive storage injections have been occurring in the spring, brining in-state storage levels up to the average level over the previous 5 years. Hydro conditions are near to normal, and the Kern River Expansion began operation in May 2003, and is delivering significant gas supplies to California.) Looking to the future, we will order PG&E and the other electric utilities to prepare a proposal for their next Gas Supply Plans, due August 15, 2003, for possibly obtaining natural gas storage capacity as of April 1, 2004. This should include a proposal for minimum storage targets as of May 31, 2004.

Moreover, we will direct PG&E to include a proposal in its next Gas Supply Plan on procedures the utility can employ to make the Wild Goose storage and PacifiCorp pipeline capacity available to the other utilities in connection with their administration of the DWR contracts in the event the utility elects not to utilize these assets. The proposal should also discuss circumstances for

brokering any unused storage and pipeline capacity in order to reduce the DWR revenue requirement and propose methods for directing any resulting revenues to DWR.

An additional consideration is the extent that PG&E may engage in inappropriate self dealing with its affiliates or operating divisions. Such abuse is possible since PG&E owns and markets, through its Golden Gate Market Center operation, gas storage (in direct competition with Wild Goose Storage) and intrastate backbone transmission services. As a case in point [Redacted] Additionally, PG&E Gas Transmission Northwest, a pipeline connecting western Canadian gas pipelines to the utility's backbone transmission system is controlled by a utility affiliate.

In D.02-10-062, we adopted standards of behavior that the utilities' must observe in connection with their procurement practices. For transactions with affiliates, Standard of Behavior No. 1 is applicable and specifies the following:<sup>16</sup> <sup>17</sup>

"Each utility must conduct all procurement through a competitive process with only arms length transactions. Transactions involving any self-dealing to the benefit of the utility or an affiliate, directly or indirectly, including an unaffiliated third party, are prohibited." (D.02-10-062, p. 51, *mimeo*)

To the extent that PG&E will consider using a utility affiliate to provide service for the DWR contracts, it must obtain a waiver from this prohibition through a petition to modify D.02-10-062.

In cases where PG&E is considering use of its utility owned facilities and services, we are concerned about PG&E's ability to engage in earnest negotiations as an agent of DWR for services offered and provided by the utility.

<sup>16</sup> D.02-10-062, placed a moratorium on SCE, PG&E and SDG&E dealing with their own affiliates in procurement transactions, beginning January 1, 2003, lasting for two years or until the rulemaking is completed, whichever date is first. (see p. 50, *mimeo*)

 $^{17}$  D.03-06-067, "Gas Procurement for the utilities' DWR is a hybrid: it should follow the same standards as gas procurement for the utilities' own contracts, yet it is reviewed under a separate Gas Supply Plan, with the review conducted annually in conjunction with DWR contract administration and least-cost dispatch." (see p. 10, *mimeo*)

<sup>18</sup> In some cases there may be competitive alternatives available to PG&E and that the utility has discretion to use its own facilities or those of another provider (e.g., gas storage). A conflict of interest is inherent in such bargaining because the utility has competing interests to increase utility profits yet protect the interests of DWR, the principal, and minimize costs. To remedy this conflict, we need a standard to gauge whether PG&E's negotiated prices for these services on behalf of DWR are the product of the competing interests of a buyer and seller in an arm's length transaction. An additional factor for consideration are PG&E's request for offers (RFO) and bids received from competitors to provide services. We will presume in such cases a reasonable price is if PG&E's charge to DWR for the use of the utility's facilities or services is the same as or lower than the volume weighted average of the price the utility negotiated for each service to others for the past 12 month period (prior to the date of this resolution). PG&E is directed to provide the volume weighted average of the prices PG&E negotiated for these services with others for the past 12 month period to the Commission's Energy Division staff. PG&E shall also retain RFO's and bids involved in the consideration of using the services of competitors.

### Risk management:

PG&E explains in its Gas Supply Plan that its gas price risk management strategy for its allocated DWR contracts is part of the utility's overall electric and fuels portfolio management program. [Redacted] Goals set for the duration of the Gas Supply Plan include: (1) evaluating the price risk position of the DWR portfolio on a regular basis, (2) executing hedges where appropriate, (3) developing a standard set of hedges, (4) establishing a pre-approved process with DWR for execution and, (5) documenting risk management procedures and controls. PG&E presents an initial list of risk management tools it may use involving products based on fixed and floating prices, swaps and options. [Redacted] The plan also includes a list of DWR approved brokers.

We cannot overstate the importance that the utilities possess the right tools and managerial skills necessary to oversee their generation portfolios during this period of extreme gas price volatility and high gas prices. Particularly, since the

<sup>18</sup> In some instances PG&E's tariff allows the utility to negotiate prices with their customers for certain services ([Redacted]

DWR gas tolling contracts represent a significant volume of gas which must be protected from adverse price movements in accordance with PG&E's approved short term procurement plan. We recognized this need in D.02-12-069, wherein we instructed the utilities to begin considering entering into hedges prior to the first of the year and allowing them to make the final decision on any hedging for the DWR contract related gas supplies.<sup>19</sup>

In its Gas Supply Plan, PG&E described the circumstances where it will hedge gas costs and identified a variety of financial products it will use to do so. On this subject, ORA commented that,

"PG&E in its GSP (Gas Supply Plan), proposes to use a wide variety of tools such as basis hedges, forward contracts, option contracts, floating-to-fixed contracts, as well as both financial and physical hedges. Under the GSP, trades could be executed via NYMEX, broker-assisted trades, RFOs, and bilateral agreements. Since each particular trading tool has its own unique risk factors, the use of a variety tools will diversify both ratepayer and shareholder risk; thereby leading to potential costs savings." (p. 1)

We concur with ORA's assessment of PG&E's array of risk management tools and note that the utility has included in its Gas Supply Plan its intent to manage the gas related DWR gas volume in connection with its approved short-term procurement plan. This approach is consistent with our directive that the utilities integrate the DWR contracts with their other generation resources, and as expressed in D. 02-09-053, wherein we stated, "The utilities shall not ... make artificial distinctions between DWR contracts and other resources in their resource portfolio." (see Ordering Paragraph 5)

Furthermore, in PG&E's response to the Energy Division data request, the utility clarified certain risk management issues [Redacted]

We believe that PG&E's risk management strategy (plus the use of gas storage as discussed above) should enable the utility to adequately protect its ratepayers from unfavorable gas price movements within its authorized consumer risk tolerance threshold and help ensure that surplus electricity is sold at a gain.

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<sup>&</sup>lt;sup>19</sup> D.02-12-069, p. 28, mimeo

In sum, we find that PG&E's decision-making strategies support our procurement objectives. As we discussed above, the effectiveness of these strategies will be considered separately.

# Actions outside scope of approved Gas Supply Plan:

PG&E states it will submit all gas supply, transportation and storage deals not contemplated in the Gas Supply Plan to DWR for review and approval. While PG&E's plan is designed to be responsive to market conditions, it is possible that a situation may arise not accounted for in the plan. Barring the utility from conducting actions outside the plan if extraordinary conditions occur runs the risk that prudent actions may fail to be executed. To prevent this situation, we will provide PG&E with the flexibility to engage in transactions outside the scope of its Gas Supply Plan, however, only if it is necessary for the utility to conduct its administrative and operational responsibilities consistent with Commission decisions and that demonstrable benefits will result for its ratepayers. However, we caution PG&E that DWR approval of any actions beyond the scope of the approved plan, or while the Gas Supply Plan filed by PG&E was pending our approval, would not insulate the utility from possible Commission sanction or color our reasonableness review.

We will require the utility to document, describe the circumstances and resulting benefits of all instances where it was necessary to operate outside the parameters of its approved Gas Supply Plan. PG&E shall notify DWR and the Commissions Energy Division when it contemplates conducting such an action. Justification of such transactions will be scrutinized in our reasonableness review of the utility's administration of the DWR contracts.

# **Consideration of Party Comments:**

We next consider the issues and suggestions raised by the parties in their comments.

ORA supports approval of PG&E's Gas Supply Plan, but notes that its position should not prejudice its standing in the utility's ERRA review. Additionally, ORA recommends that PG&E should limit its use of DWR credit support only when it will result in lower expected gas prices. In response, PG&E says that the scope of the ERRA review for activities under the Gas Supply Plan is limited to

evaluating whether or not PG&E's activities in the area comply with its Gas Supply Plan. The utility also claims that DWR credit support is crucial to allow the utility to conduct transactions with counterparties due to its own distressed financial situation.

We disagree with ORA's and PG&E's interpretation of the purpose of the ERRA balancing account. In D. 02-10-062, we established the ERRA to record costs related to the utilities' retained generation, qualify facilities (QF) contracts, bilateral contracts and other approved items. The issue of the administration of the DWR contracts it was allocated and associated gas tolling provisions will be conducted in the annual procurement review process established in D.02-09-053. In addition, we deny ORA's recommendation concerning the use of DWR credit support. In D. 02-12-069, we stated that DWR rather than the utilities should provide credit support for gas purchases related to the DWR contracts.<sup>20</sup> Use of DWR credit and collateral for other activities is in keeping with the Department's financial obligations.

In its comments, DWR generally seeks to incorporate or impose certain items and conditions into PG&E's Gas Supply Plan and requests clarification of various items in the plan. We will consider each of the issues presented by DWR, summarize PG&E's response, and then provide our position.

#### Issue 1:

Refer to Confidential Appendix.

#### Issue 2:

DWR notes that most of PG&E's financial hedge mechanisms depend on the validity of published gas price indices and, in reference to concerns about manipulation, the Department believes that the utility should explain why these indices are valid, what risks are associated with their use, and what monitoring it should undertake to ensure that the indices are reliable.

PG&E states that it is the terms of the gas tolling provisions which require it to depend on indices for physical gas supplies and hedging tools and that efforts are underway by FERC and others to ensure that the indices are dependable.

<sup>&</sup>lt;sup>20</sup> D.02-12-069, p. 30, *mimeo*.

Additionally, the utility notes that it does not possess the ability to gauge the veracity of gas price data beyond its own price reporting practices.

We share DWR's concerns about the manipulation of gas price indices and are hopeful that FERC's attention to validate price reporting and the recent enforcement activities concerning fraudulent behavior in this area will strengthen the integrity of published gas price indices. We believe these actions will help provide an incentive to dissuade any entities from engaging in manipulation in this area going forward. Without any evidence to the contrary before us, we find that PG&E's response represents an honest appraisal of its ability to police the reliability of published gas price indices and, therefore, find no need for PG&E to provide the analysis DWR requests. Furthermore, we note that in D. 02-10-062, we authorized the use of a number of procurement products that are based on indices and see no need to impose a prohibition against the use of such indices in the administration of the gas tolling provisions.

#### Issue 3:

DWR seeks clarification of how PG&E intends to provide risk management support.

PG&E notes that its risk management activities are conducted on its customers' behalf and in order to manage its net open position and that any such activity related to the DWR contracts is subsumed in this function.

We find that PG&E has adequately explained its risk management support activities.

#### Issue 4:

Refer to Confidential Appendix.

#### Issue 5:

DWR seeks to change the second paragraph of Section 4.b.vi of PG&E's Gas Supply Plan by subjecting all PG&E gas transactions to a set of protocols, in the form of instructions from principal to agent, to be provided at a future date which can be revised at the Department's discretion. Actions outside the protocols would be subject to prior review and DWR approval. Additionally, DWR wants to: (1) condition all hedges to prior review and approval if the counterparty so requires; (2) prohibit utility self-dealing unless reviewed and approved by DWR; (3) reserve the right to request additional information

regarding the plan, impose a dollar limit on transactions, impose restrictions based on limitations to DWR credit and collateral levels, impose additional limitations based upon the Gas Supply Plans approved for SCE and SDG&E, and, (4) require PG&E to certify that each transaction submitted to DWR complies with the approved Gas Supply Plan and protocols.

PG&E generally objects to being bound to a set of protocols it has not seen and argues that doing so is unreasonable. The utility also agrees with the basic principle against self-dealing, but states that without a description of what constitutes such a transaction, it would be difficult to comply with this restriction. It also notes that certain transactions with its business units should not necessarily be considered self-dealing.

The utility does not object to the Department's recommendations that: 1) all gas transactions entered into and on behalf of DWR be presented to and signed by DWR, 2) DWR will review and approve all proposed hedge transactions where a counterparty so requires; 3) it provide DWR with additional information within the scope of the Gas Supply Plan. Furthermore, PG&E is willing to work with DWR on establishing dollar amount limitations on transactions.

We agree with PG&E that it should not be bound by protocols it has not reviewed and which would be presented at a future date. Our responsibility to oversee the utility's gas tolling related activities would be diminished if we adopted DWR's request and provided the Department with a blank check to impose unspecified conditions on PG&E's actions. We must maintain our regulatory oversight over PG&E and, therefore, deny DWR's recommendation. Although we deny this open-ended request, DWR should be aware that the approved Operating Agreement provides the Department with an opportunity to limit PG&E's activities. In specific, DWR can impose limitations on gas transportation and storage negotiations as well as reject aspects of the Gas Supply Plan we approve that it deems unacceptable.<sup>21</sup> DWR should provide the Commission with any limitations it has imposed on PG&E in this regard. In the event that any desired condition cannot be implemented under the provisions of

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<sup>&</sup>lt;sup>21</sup> D.03-04-029, "The revisions allow DWR to provide the utilities with additional up-front information regarding contract limits, and approved suppliers, which the utilities will then incorporate into their Gas Supply Plans and gas procurement activities." (p. 22, *mimeo*)

the Operating Agreement, DWR should work with PG&E to develop mutually acceptable protocols for inclusion in its next Gas Supply Plan. If this approach is unproductive, DWR can present its specific concerns for our consideration in the procedures specified in D. 03-04-029.

We also deny the following items unrelated to the protocols. On the issue of self-dealing, the bounds placed on the utility's activities discussed above obviate the need for and further review or subsequent approval of such actions. We also find it unnecessary to require the utility to certify that its transactions are in compliance with the Gas Supply Plan, since the utility is bound to observe the approved plan except under the conditions describe above.

We find most items DWR seeks to reserve the right to apply either vague or inappropriate. We deny conditioning PG&E's Gas Supply Plan to those plans approved for SCE and SDG&E. Since each utility has operational differences which their Gas Supply Plans must account for, we refuse to give DWR carte blanche authority to incorporate into PG&E's Gas Supply Plan items approved in the other utilities' plans with which might not be appropriate. On credit and collateral limitations, PG&E specifies in its Gas Supply Plan that it will base its decisions upon the Department's credit and collateral situation, which is consistent with DWR's financial obligations. Since DWR does not specify what dollar limits it seeks to apply, we cannot determine how such limitations may affect the utility's ability to fulfill its obligations under the plan and, therefore, deny DWR's request.

We find the following items, which PG&E also accepts, as reasonable for incorporation into the utility's Gas Supply Plan. These items are: 1) obtaining DWR approval of hedges if required by the counterparty, 2) submitting contracts to DWR for signature, and; 3) providing additional requested information to DWR.. For those instances involving counterparties requiring DWR approval, we instruct PG&E to document these cases and describe them in its Gas Supply Plans.

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<sup>&</sup>lt;sup>22</sup> D.03-04-029, "We expect DWR to file comments on the utilities' Advice Letter filings as necessary to identify any concerns they may have regarding the plans. These concerns will be taken into account in the Commission's decision." (p. 24, *mimeo*)

#### Issue 6:

DWR requests that the Gas Supply Plan, be modified to reflect dates that invoices should be processed and that the utility will provide any requested documentation the Department needs to verify invoices.

PG&E accepts DWR's suggested changes.

We find the suggested changes reasonable and will direct PG&E to modify its Gas Supply Plan accordingly through a supplemental filing.

Issue 7:

See Confidential Appendix.

#### Issue 8:

DWR requests that Commission's approval of the plan contain a statement acknowledging that plan shall constitute prior consultation with DWR for purposes of the definition of Priority Long Term Power Contracts as that term is defined in the Rate Agreement. <sup>23</sup>

PG&E does not oppose DWR's request, but notes that if the Commission deems such a statement appropriate, it belongs in the resolution approving the plan rather than in the Gas Supply Plan. According to PG&E, this is proper since the Rate Agreement is between DWR and the Commission, and PG&E is not a party to it.

We deny DWR's request because they did not show why it is necessary to include such a provision in the utility's Gas Supply Plan.

Issue 9:

See Confidential Appendix.

<sup>&</sup>lt;sup>23</sup> D.02-02-051 approved a "Rate Agreement" between the PUC and DWR to facilitate DWR's issuance of Bonds authorized by Water Code section 80130.

# **Conclusion:**

We approve PG&E's Gas Supply Plan, subject to the following items:

- 1) The Gas Supply Plan as modified is in effect for the period beginning March 25, 2003 (the date the AL was filed with the Commission) and until the next plan is approved by the Commission.
- 2) PG&E shall include a section stating it will submit all transactions the utility negotiates to DWR for execution and that any such agreement it negotiates will specify that the utility is authorized to act for and on behalf of DWR as a limited agent.
- 3) Transactions outside the scope are to be documented and presented in the next Gas Supply Plan with an explanation why such actions were necessary.
- 4) PG&E should make the final decision with regard to hedges, except in those cases where counterparties require DWR approval. PG&E is required to use DWR approved counterparties for all over-the-counter transactions.
- 5) PG&E shall conduct its role as a Fuel Supplier or Fuel Manager as specified in the Confidential Appendix.
- 6) PG&E shall include those suggestions made by DWR it accepted to adopt and we found reasonable, as discussed above.
- 7) PG&E is directed to confer with DWR concerning the items discussed in the Confidential Appendix.

We will also expect PG&E to complete the various analytical models and procedures under development mentioned in its Gas Supply Plan. Furthermore, the utility should provide greater detail in its next Gas Supply Plan explaining how all models and analytical tools will be used (e.g., how rankings are performed, criteria used, etc.) with examples in support of its decision-making processes. A more detailed and descriptive plan will obviate the need for staff inquiries and eliminate the attendant delay in approval.

The next Gas Supply Plan should be filed August 15, 2003 for the period of October 1, 2003 through March 31, 2004. This filing should be submitted in

accordance with the utility's approved Operating Agreement in effect at the time of filing, as appropriate. The Gas Supply Plan approved in this resolution will remain in effect until PG&E's next plan is approved.<sup>24</sup>

# **COMMENTS**

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(3) provides that this 30-day period may be reduced/waived by Commission adopted rule.

The 30-day comment period has been reduced per the directive issued in D. 02-12-069 and D.03-04-029, wherein we stated that, "the Energy Division will prepare a resolution for Commission approval on an expedited basis." (pp. 23-24, *mimeo*)

# **FINDINGS**

- 1. PG&E filed AL 2359-E on March 25, 2003 requesting expedited approval of its Gas Supply Plan for DWR contract gas tolling provisions for the period of March 1, 2003 through August 31, 2003.
- 2. ORA filed comments on April 4, 2003 in support of the AL except for the conditional use of DWR credit and that the utility's activities should be reviewed in the utility's ERRA filing.
- 3. PG&E filed a reply to ORA's comments on April 8, 2003 contesting ORA's interpretation of the purpose of the ERRA proceeding and the suggested use of DWR credit.

<sup>24</sup> D.03-04-029, PG&E Exhibit B, Section IV, provides conditions under which the approval process may be revised.

<sup>&</sup>lt;sup>25</sup> D.03-04-029, "The adopted Gas Supply Plans will remain in effect until subsequent Plans are filed and approved." (see p. 25, *mimeo*)

- 4. DWR filed comments on April 7, 2003 recommending approval of the AL subject to the imposition of protocols and other conditions as well as requesting additional information about the Gas Supply Plan.
- 5. PG&E filed a reply to DWR's comments on April 11, 2003 rejecting DWR's request for imposing protocols except in certain limited applications.
- 6. PG&E filed AL 2359-E prior to the effective date of its Operating Agreement with DWR.
- 7. PG&E is subject to the Operating Order adopted in D.02-12-069 until approval of its Operating Agreement on April 17, 2003.
- 8. It is reasonable to review the Gas Supply Plan filed in AL 2359-E under the terms and conditions of the Operating Agreement, as of April 17, 2003 and the Operating Order prior to this date.
- 9. D.02-09-053 established an annual review of the reasonableness of the utilities' administration of DWR contracts.
- 10. D.02-09-053 order PG&E to administer several DWR power contracts, some of which contain gas tolling provisions.
- 11. D. 02-10-062 established minimum standards of behavior governing the utilities' administration of its generation resource portfolio, which includes DWR contracts.
- 12. PG&E's Gas Supply Plan filed in AL 2359-E contains most of the elements specified in the Operating Order and the Operating Agreement.
- 13. It is reasonable to require PG&E to modify its Gas Supply Plan to conform to the terms and conditions of the Operating Order and Operating Agreement.

# **THEREFORE IT IS ORDERED THAT:**

- 1. PG&E AL 2359-E and the utility's Gas Supply Plan is approved as modified as follows:
  - a) the Gas Supply Plan will be in effect for the period beginning March 25, 2003 and until PG&E's next Gas Supply Plan is approved by the Commission;
  - b) the proposal to condition gas transportation and storage transactions exceeding terms of three months or \$10 million dollars subject to DWR approval is denied per the terms and conditions of PG&E's approved Operating Agreement;

- c) the addition of risk management products is subject to Commission approval;
- d) the utility shall make the final decision with regard to the use of risk management tools, unless a counterparty requires DWR approval;
- e) the utility is required to use DWR approved counterparties for over-the-counter risk management transactions. In the event PG&E believes such a limitation is too restrictive or problematic it shall confer with DWR to develop mutually satisfactory counterparty creditworthiness standards for inclusion in its next Gas Supply Plan.
- f) the utility must observe the standards of behavior adopted in D.02-10-062, including the prohibition against self dealing.
- 2. PG&E is authorized to pursue activities outside the scope of the approved Gas Supply Plan, subject to Commission reasonableness review, in the event extraordinary circumstances arise and it is necessary for the utility to meet its administrative and operational responsibilities consistent with Commission decisions. PG&E shall document and describe these occurrences including an explanation of resulting ratepayer benefits. Additionally, the utility is required to notify DWR and the Commission's Energy Division when contemplating taking such actions via a letter.
- 3. PG&E is authorized to transact for utility owed facilities subject to a presumption of reasonableness standard based upon the volume weight average of prices it negotiated with others (except for DWR) for such services 12 months prior to the effective date of this resolution. PG&E shall also retain all RFO's and bids received from competitors for such services.
- 4. PG&E is directed to assume the role of Fuel Manager and Fuel Supplier as directed in the Confidential Appendix.
- PG&E shall file a supplement to AL 2359-E with a revised Gas Supply Plan as follows:

- a) remove references to submitting gas transportation and storage deals exceeding terms of three months or value of \$10 million for DWR review and approval;
- b) include procedures for forwarding negotiated agreements to DWR for execution as contemplated in the Operating Order and Operating Agreement;
- c) specify that the addition of financial risk management tools are subject to Commission approval;
- d) the utility will make the final decision concerning gas hedges and the use of risk management tools unless a counterparty requires DWR approval;
- e) reflect the utility's election as Fuel Supplier or Fuel Manager as discussed in the Confidential Appendix;
- f) include the approved recommendations of DWR identified in OP 11.
- 6. The supplemental advice letter referred to in OP 5 shall be filed within 10 days of the effective date of this resolution effective March 25, 2003, subject to Energy Division review.
- 7. PG&E is directed to confer with DWR as stipulated in the Confidential Appendix.
- 8. PG&E shall retain any and all analysis, forecasts, related information and material used to support decisions made under the Gas Supply Plan for Commission review.
- 9. PG&E is ordered to file its next Gas Supply Plan on August 15, 2003 for the period of October 1, 2003 through March 31, 2004 which includes the information specified in OP 12.
- 10. ORA's recommendation to condition the use of DWR credit under certain circumstances is denied.

- 11. DWR's protest is denied except for: 1) requiring PG&E to submit all gas transactions entered on behalf of DWR be presented to DWR and signed by DWR; 2) allowing DWR to review and approve all hedge transactions requiring DWR approval if a counterparty so requires; 3) submitting information to DWR within the scope of the approved Gas Supply Plan at DWR's request, and; 4) modification of the invoice approval process.
- 12. PG&E's next Gas Supply Plan shall contain all required information specified in the Operating Order or the utility's Operating Agreement, as applicable and include the following:
  - a) a proposed plan for obtaining gas storage capacity as of April 1, 2004 as well as proposed minimum storage targets for May 31, 2004;
  - b) a proposal showing how unused pipeline or storage capacity can be made available to the other utilities in connection with their DWR contract related duties or brokered;
  - c) detailed information describing models and analytical techniques (e.g., inputs for cost/benefit analysis, ranking procedures, criteria, examples etc.) used for making decisions pursuant to the Gas Supply Plan.
- 13. PG&E shall provide the volume weighted average of the prices it negotiated with others (except as a limited agent of DWR) for services owned by the utility for the previous 12 months from the date of this resolution.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on July 10, 2003; the following Commissioners voting favorably thereon:

WILLIAM AHERN Executive Director

# **Confidential Appendix**

This appendix discusses confidential aspects of PG&E's Gas Supply Plan and issues raised in DWR's written comments.

[Redacted]